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# Corporate Governance within the Romanian Bank Sistem

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## Abstract

By using the model of the score function (Spătăcean, I.O. and Ghiorgăiță, L., 2012), the current research work aims to identify the degree to which the concepts, principles and techniques typical to Corporate Governance are spread, by taking 14 Romanian credit institutions as reference.

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**Keywords:** Corporate governance, ethical code, credit institution, score function, Romania.

## 1. Introduction

In the context of the new economy, the issue of corporate governance within the financial-bank system increases the interest of practitioners and European [COM(2010) 284 final] and world organizations, interested in promoting some international governance principles, either that we talk about the OECD principles, the recommendations of the Basel Committee in the bank field or community law (The Directive 2006/46/EC forces financial institutions classified on a regulated market to elaborate a corporate governance code which they have to abide by and to point out which are the parts of the code from which they derogate and the reasons for that). We do not aim to present the issues related to corporate governance within the bank system, where there already exist excellent observers (Mehran H. and others, 2011, Mehran H. and Mollineaux L., 2012, de Haan J. and Vlahu R, 2013), but rather to make an analysis of the capacity of the Romanian bank system to abide by the provisions in the field of corporate governance.

In the Romanian legal system, both the laws in force (The Corporate Governance Code of the Bucharest Stock Exchange) and the most recent studies (Bunea M., 2013, Spătăcean I.O. and Ghiorgăiță L., 2012) admit that, when it

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comes to dealing with the report conditions on the corporate governance applying to credit institutions, the following analysis pillars/axes are relevant for testing the degree of observing the principles typical to the field:

1. governance and control structures of credit institutions, as well as their activity, paying a special attention to the Administration Board;
2. the role of monitoring authorities and interest conflicts;
3. the treatment of minority shareholders and the situation of interests owners;
4. risks governance and adjustment of the internal control function to the risk profile of the institution;
5. internal audit;
6. ethics.

Unfortunately, those involved in the Romanian bank system have not managed to really understand risks, so that several gaps of discontinuity and a strong lack of authority in terms of decisional factors have been registered, the immediate consequence being the creation of a considerable trust deficit in credit institutions; the fields particularly affected are: *conflict interests, the effective enforcement of corporate governance principles, the role of monitoring authorities and auditors*. In this context, in order to accomplish our objective, we have deemed necessary to expand our research, from the 6 pillars initially presented, to a thorough analysis and presentation of the concepts/attributes, building up a set of 10 hypotheses which are to be evaluated within the Romanian bank area.

## 2. Model

The current study involves both a qualitative and quantitative approach, on the basis of the empirical data gathered out of a sample of 14 credit institutions. The qualitative side of the approach is explained by the fact that the study has required interpretations, explanations, understanding of the phenomena analysed, while the quantitative side has been focused on quantifications and numerical expressions, using a score system based on a function determined for each credit institution. The data collection phase has been based on techniques of mediated collection of information from the *Corporate Governance Codes* posted on the websites of the banks analysed, but also from the *Published Annual Reports*; the score function has allowed for transforming the data with an assertive and qualitative character into numerical quantitative data.

The sample analysed is composed of four banks with Romanian capital: Banca Comercială Carpatica, Banca Transilvania, CEC Bank, EXIM Bank and by ten credit institutions activating within some international holdings: BCR, BRD, Unicredit, Volksbank, Raiffeisen, ING Bank, OTP Bank, Garanti Bank, Millennium Bank, Banca Românească.

The research project proposed aims to identify the degree to which the Romanian credit institutions abide by the provisions of corporate governance, so as to maximize their performance. In order to achieve this goal, a set of 10 hypotheses has been elaborated:

Hypothesis No. 1: The Administration and Independence Board

Hypothesis 2: Identifying the competences corresponding to the responsibilities taken upon by the members of the Administration Board.

Hypothesis 3: Executive board accountable for and familiarized with bank risks

Hypothesis 4: Adequate standards for remunerating the executive board

Hypothesis 5: Treatment of shareholders and interests owners

Hypothesis 6: The role of the Audit committee and internal audit risk oriented

Hypothesis 7: The risks governance function

Hypothesis 8: Adjusting the internal control function to the risk profile of the credit institution and monitoring operational objectives

Hypothesis 9: Financial transparency and report

Hypothesis 10: Ethical code

By using the professional reasoning for the hypotheses mentioned above, we have assigned an importance coefficient  $k_i$ , typical to each pillar considered to be relevant for the enforcement of corporate governance provisions in the Romanian bank system, as it can be seen in Figure no. 1.

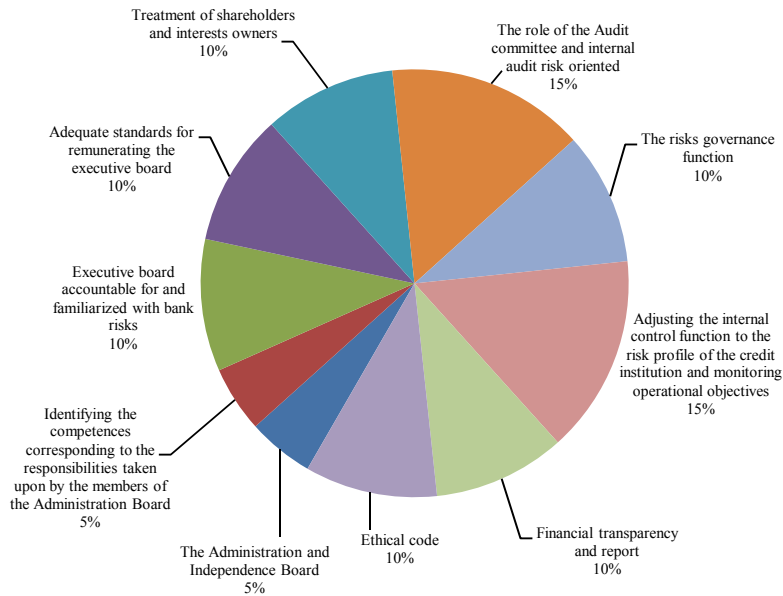


Fig.1. Relevant analysis axes and levels of importance associated to them within Corporate Governance  
Source: Author's Projection

Moreover, to each answer analysed from the statement “*Enforce or explain*”, and from the *Published Annual Reports* (according to the case) it has been assigned a distinct conformity mark  $\alpha_i$ , as it can be seen in Table no. 1.

Table No. 1 The significance of the marks given to the information collected and interpreted

Mark	Significance
0	The credit institution has not published any relevant document regarding CG (The Statement <i>Enforce or explain</i> , <i>Annual reports</i> )
1	The credit institution has published satisfactory information (partial data, not-updated information) which do not allow for settling the cases related to CG and making recommendations.
2	The documents regarding CG are found on the websites of the credit institutions analysed in a proportion of 70%; the information available allows for settling the cases/issues related to CG at a medium level.
3	The dissemination of information meets the maximum of 100%, by offering complete transparent reports, which are also according to an efficient CG

Source: Author's Projection

By starting from the importance coefficient  $k_i$  assigned to each pillar considered essential in the analysis initiated in the Romanian bank system, and from the marks  $\alpha_i$  associated to each pillar, we have obtained the value of the score function  $F(x)$  (Spătacean I.O. and Ghiorghiță L., 2012) for the 14 banks studied. The value of the score function shows the final mark assigned to each credit institution, in the form of an expression of conformity with the corporate governance instruments in the field, as it can be seen in Table no. 2.

Table No. 2 Quantitative determinations regarding the conformity with the working hypotheses proposed

Field of interest	Carp	BT	CEC	Exim	BRD	BCR	Raiff	Garanti	Volk	OTP	ING	Mille	BR	UniC
The Administration and Independence Board	3	3	2	1	3	3	2	2	2	1	1	1	1	2
The identification of the competences corresponding to	3	3	3	2	3	3	3	2	2	2	2	2	2	3

the responsibilities taken upon by the members of CA														
The executive board in charge and familiarized with bank risks	3	3	3	3	3	3	3	3	3	3	3	3	3	3
Adequate standards for remunerating the executive board	3	3	2	2	3	3	2	3	3	2	2	2	2	3
The treatment of shareholders and interests owners	3	3	3	3	3	3	3	3	3	3	3	3	3	3
The Role of the Audit Committee and the internal audit oriented towards risk	3	3	2	2	2	3	2	2	2	3	3	3	3	2
The function of risk governance	3	3	3	3	3	3	3	3	3	3	3	3	3	3
Adjusting the internal control function to the risk profile of the credit institution	3	3	3	2	3	3	2	3	2	2	3	2	2	3
Financial transparency and report	3	2	2	3	3	3	3	2	2	3	3	2	2	3
Ethical Code	3	2	2	2	2	3	2	2	2	2	2	2	2	2

Source: Author's Projection

The equation used for the score function is:

$$F(x) = \left( \sum k_i x \alpha_i \right) \times 100/3 \quad \text{where,} \quad (1)$$

$k_i$  – the importance coefficient assigned to each pillar of interest of corporate governance, on the basis of professional reasoning,

$\alpha_i$  – the mark assigned to the information collected and interpreted from the reports published, on the basis of the professional reasoning, inserted in Table No. 1,

3 – maximum mark given.

### 3. Results

Values of the score function:

*Banca Comercială Carpatica*:  $F(x) = (5\% \times 3 + 5\% \times 3 + 10\% \times 3 + 10\% \times 3 + 10\% \times 3 + 15\% \times 3 + 10\% \times 3 + 15\% \times 3 + 10\% \times 3 + 10\% \times 3) \times 100/3 = 100$

*Banca Transilvania*:  $F(x) = (5\% \times 3 + 5\% \times 3 + 10\% \times 3 + 10\% \times 3 + 10\% \times 3 + 15\% \times 3 + 10\% \times 3 + 15\% \times 3 + 10\% \times 2 + 10\% \times 2) \times 100/3 = 93,33$

*CEC Bank*:  $F(x) = (5\% \times 2 + 5\% \times 3 + 10\% \times 3 + 10\% \times 2 + 10\% \times 3 + 15\% \times 2 + 10\% \times 3 + 15\% \times 3 + 10\% \times 2 + 10\% \times 2) \times 100/3 = 83,33$

*Exim Bank*:  $F(x) = (5\% \times 1 + 5\% \times 2 + 10\% \times 3 + 10\% \times 2 + 10\% \times 3 + 15\% \times 2 + 10\% \times 3 + 15\% \times 2 + 10\% \times 3 + 10\% \times 3) \times 100/3 = 83,33$

$$10\% \times 2) \times 100/3 = 78,33$$

$$BRD: F(x) = (5\% \times 3 + 5\% \times 3 + 10\% \times 3 + 10\% \times 3 + 10\% \times 3 + 15\% \times 2 + 10\% \times 3 + 15\% \times 3 + 10\% \times 3 + 10\% \times 2) \times 100/3 = 91,67$$

$$BCD: F(x) = (5\% \times 3 + 5\% \times 3 + 10\% \times 3 + 10\% \times 3 + 10\% \times 3 + 15\% \times 3 + 10\% \times 3 + 15\% \times 3 + 10\% \times 3 + 10\% \times 3) \times 100/3 = 100$$

$$Raiffeisen Bank: F(x) = (5\% \times 2 + 5\% \times 3 + 10\% \times 3 + 10\% \times 2 + 10\% \times 3 + 15\% \times 2 + 10\% \times 3 + 15\% \times 2 + 10\% \times 3 + 10\% \times 2) \times 100/3 = 81,67$$

$$Garanti Bank: F(x) = (5\% \times 2 + 5\% \times 2 + 10\% \times 3 + 10\% \times 3 + 10\% \times 3 + 15\% \times 2 + 10\% \times 3 + 15\% \times 3 + 10\% \times 2 + 10\% \times 2) \times 100/3 = 85,00$$

$$Volksbank: F(x) = (5\% \times 2 + 5\% \times 2 + 10\% \times 3 + 10\% \times 3 + 10\% \times 3 + 15\% \times 2 + 10\% \times 3 + 15\% \times 2 + 10\% \times 2 + 10\% \times 2) \times 100/3 = 80,00$$

$$OTP Bank: F(x) = (5\% \times 1 + 5\% \times 2 + 10\% \times 3 + 10\% \times 2 + 10\% \times 3 + 15\% \times 3 + 10\% \times 3 + 15\% \times 2 + 10\% \times 3 + 10\% \times 2) \times 100/3 = 83,33$$

$$ING Bank: F(x) = (5\% \times 1 + 5\% \times 2 + 10\% \times 3 + 10\% \times 2 + 10\% \times 3 + 15\% \times 3 + 10\% \times 3 + 15\% \times 3 + 10\% \times 3 + 10\% \times 2) \times 100/3 = 88,33$$

$$Millenium Bank: F(x) = (5\% \times 1 + 5\% \times 2 + 10\% \times 3 + 10\% \times 2 + 10\% \times 3 + 15\% \times 3 + 10\% \times 3 + 15\% \times 2 + 10\% \times 2 + 10\% \times 2) \times 100/3 = 80,00$$

$$Banca Românească: F(x) = (5\% \times 1 + 5\% \times 2 + 10\% \times 3 + 10\% \times 2 + 10\% \times 3 + 15\% \times 3 + 10\% \times 3 + 15\% \times 2 + 10\% \times 2 + 10\% \times 2) \times 100/3 = 80,00$$

$$Uni Credit: F(x) = (5\% \times 2 + 5\% \times 3 + 10\% \times 3 + 10\% \times 3 + 10\% \times 3 + 15\% \times 2 + 10\% \times 3 + 15\% \times 3 + 10\% \times 3 + 10\% \times 2) \times 100/3 = 90,00$$

With a score average of 86,79 out of a total of 100 points, only six entities were above the average (Banca Comercială Carpatica, Banca Transilvania, BRD, BCR, ING Bank, UniCredit). All the other did not overcome the average, as a result of the difficulties encountered in adjusting the internal control/audit function to the risk profile of the entity, the non-settlement of the independence issue of the members of the Administration Board, the promotion of standards which are not fit for remunerating the executive board, the partial/incorrect enforcement of the Ethical Code provisions.

## Conclusions

As the current research project is characterized by novelty (the enforcement of the governance concepts is only at the beginning in Romania), from the scores obtained by the credit institutions analysed it can be noticed, in a general approach, the interest paid by the leadership of banks and the parties involved (shareholders, employees and so on) to the basic structures/pillars of corporate governance. And even if some absences and flaws have been identified in enforcing the provisions/principles of corporate governance, as a result of the systemic risk encountered in the bank system, Romanian credit institutions are now on the path of implementing and going thorough into the basic concepts/pillars of corporate governance.

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